No. 83-1686

In The

Supreme Court of the United States

October Term, 1983

In Re:

EASTERN BANCORPORATION,

Petitioner,

(FORMER OFFICERS AND DIRECTORS OF EASTERN BANCORPORATION),

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Were the people who authorized the filing of a bankruptcy petition on behalf of Eastern Bancorporation (Eastern), officers and directors of Eastern, as they purported to be; that is, were they validly elected under Pennsylvania law?

LIST OF PARTIES

Eastern Bancorporation is the respondent herein. It was put into bankruptcy by the petitioners, who purported to be acting as officers and directors of Eastern. The District Court and the Third Circuit Court of Appeals held that the petitoners had never been elected officers and directors of Eastern under the governing Pennsylvania corporate law statutes.

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STATUTES INVOLVED

The only statutes involved are the Pennsylvania corporate law statutes relating to the election of officers and directors; 15 P. S. §§1501(c), 1502, 1506 and 1509.

STATEMENT OF THE CASE

The material facts are undisputed. On March 12, 1976, First Pennsylvania Bank N.A. ("First Pennsylvania") entered into a

loan transaction with State Bancshares, Inc. ("SBI") (App. 3:606).[1] On February 2, 1977, the loan was restructured, at which time SBI delivered to First Pennsylvania two blank stock powers in Eastern Bancorporation ("Eastern"), each representing 750,000 shares of Eastern's common stock (App. 2:400-402, 2:435-463, 3:606).

SBI subsequently defaulted on the restructured loan (App. 3:607). First Pennsylvania, therefore, devised a plan whereby it would cause Eastern to file a petition for reorganization under Chapter 11 of the Code (App. 2:312, 2:575).

By letter dated October 25, 1980, First Pennsylvania requested Eastern's secretary to transfer the 1,500,000 shares owned by SBI into First Pennsylvania's name (App. 1:214, 3:606-607). This was not done. SBI's stock in Eastern, like all of Eastern's stock, bore a restriction stating that the shares could not be transferred unless Eastern's counsel rendered an opinion that the proposed transfer would not result in a violation "of applicable state and federal securities laws or the Bank Holding Act of 1956." (App. 2:327). Eastern's counsel was unwilling so to opine both because the requested transfer appeared to be in violation of the terms of the Financial Institution Article of the Code of Maryland and because it appeared to be in violation of the Federal Bank Holding Company Act (App. 1:257-258).

Nevertheless, although First Pennsylvania never became the record owner of SBI's stock in Eastern, the bank, by letter dated October 24, 1980, notified the secretary of Eastern to forward to the stockholders of Eastern a notice that First Pennsylvania as the "record owner of 1,500,000 shares of Eastern

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1. All references to the Appendix (filed with the Third Circuit) are cited as "App. x:y," the "x" denoting the volume of the Appendix, and the "y" denoting the page(s) of that Appendix.

Bancorporation common stock" had called a special meeting of Eastern's shareholders (App. 1:255). Eastern's secretary did not, of course, forward First Pennsylvania's notice to Eastern's stockholders. In addition to the fact that First Pennsylvania was not a record shareholder in Eastern, it would not have had a right to call a special shareholders meeting even if it had been a shareholder. 15 P. S. §1501(c) expressly provides that a shareholder may not fix the date of a special shareholders meeting unless the secretary of the corporation fails to set a date within 60 days.

Nevertheless, ignoring the fact that it was not a shareholder in Eastern, that it had no right to call a special shareholders meeting, and that the minority shareholders had not been notified of the meeting, First Pennsylvania proceeded to hold a special shareholders meeting on October 31, 1980 (App. 1:259-270). At that meeting — attended only by representatives of First Pennsylvania — the bank "elected" a new board of directors. The new board then met and authorized the filing of a petition for reorganization under Chapter 11 of the Bankruptcy Code (App. 1:271-289).

The Chapter 11 petition so authorized was filed on November 12, 1980. On November 26, 1980, Eastern filed a motion to dismiss that petition. The Bankruptcy Court denied that motion on October 7, 1982. The District Court reversed the Bankruptcy Court on February 24, 1983, holding that the Bankruptcy Court had no jurisdiction over the subject Chapter 11 bankruptcy petition because it was filed without authorization. Following a December 16, 1983 argument before the Third Circuit Court of Appeals, the Third Circuit affirmed the District Court's order on December 21, 1983.

SUMMARY OF ARGUMENT

The only issues raised in the instant litigation concern the interpretation and application of Pennsylvania corporate law.

The petitioner, the District Court and the Third Circuit have all recognized (i) that the Bankruptcy Court was without jurisdiction to consider the Chapter 11 petition if the filing of the petition was not authorized by Eastern, and (ii) that in order to prove that Eastern authorized the filing of the petition, the petitioner had to establish that the people who gave that authorization were validly elected directors and officers under Pennsylvania law. The only issue on which the petitioners differed with the District Court and the Third Circuit was as to whether the people who authorized the filing of the bankruptcy petition were, in fact, validly elected under Pennsylvania law. The District Court held that they had not been validly elected for a plethora of reasons, and the Third Circuit summarily affirmed.

The petitioner's argument relating to the equitable powers of the bankruptcy courts are, therefore, totally besides the point. The subject Chapter 11 petition was dismissed for jurisdictional reasons.

REASONS FOR DENYING THE WRIT

Neither the petitioner nor any of the courts below disputed the three fundamental principles upon which Eastern's motion to dismiss was based; in light of those principles, however, the Bankruptcy Court was necessarily obligated to grant the motion to dismiss, and the District Court and Third Circuit so recognized.

First, neither the petitioner nor any court disputed that the Bankruptcy Court was without jurisdiction to consider the Chapter 11 petition if the filing of the petition was not authorized by Eastern. As summarized by the Supreme Court in *Price v. Gurney*, 324 U.S. 100, 65 S. Ct. 513, 517 (1945), if parties "are to be allowed to put their corporation into bankruptcy, they must present credentials to the bankruptcy court showing their authority." The debtor in *Price* could not make such a showing; the Court,

therefore, affirmed the dismissal of the bankruptcy petition on the ground that "[t]he jurisdiction which Congress has given the bankruptcy court over the debtor and its property . . . does not extend to this situation." 65 S. Ct. at 516.

The second fundamental principle that the petitioner and the courts below did not dispute was that in order to prove that Eastern authorized the filing of the petition, the petitioner had to establish that the people who gave that authorization were validly elected directors under local law. *See, e.g., In re Mississippi Valley Utilities Corp.*, 2 F. Supp. 995, 997 (D. Del. 1933) (adjudication of bankruptcy vacated because the "directors" who authorized the filing of a bankruptcy petition had been elected at a shareholder meeting that had not been properly noticed); *In re Campbell County Hardware Co.*, 15 F. 2d 78, 81 (E.D. Tenn. 1924) (adjudication of bankruptcy vacated because, *inter alia*, it did "not appear that the special [shareholders] meeting was called in pursuance of article 1, section 3, of the by-laws"); *see also, In re Joseph Feld & Co.*, 38 F. Supp. 506, 507 (D.N.J. 1941) ("[t]he Court . . . should not assume jurisdiction of a 'voluntary proceeding,' which, as in this case, is based on an invalid resolution which had its origin in an illegal meeting of directors").

Finally, the third fundamental principle that the petitioner and the courts below did not dispute was that if, in fact, the people who authorized the filing of the petition were not validly elected, the petition had to be dismissed regardless of whether (had First Pennsylvania acted differently) they *could* have been validly elected. That was the precise holding in *Price v. Gurney*.

> If the District Court finds that those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceedings, it has no alternative but to dismiss the petition. ***It is not enough that those who seek***

> *to speak for the corporation may have the right to obtain that authority.* . . . [N]owhere is there any indication that Congress bestowed on the bankruptcy court jurisdiction to determine that those who in fact do not have the authority to speak for the corporation as a matter of local law are entitled to be empowered to file a petition on behalf of the corporation. (65 S. Ct. at 516-17). (Emphasis added.)

In its opinion, the District Court recognized that, as applied to the undisputed facts in this case, those principles necessitated dismissal of the subject bankruptcy petition for at least three independent reasons.

I.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE FIRST PENNSYLVANIA WAS NOT A SHAREHOLDER OF EASTERN.

The petitioner has never disputed that it must prove that the "directors" who put Eastern into bankruptcy were validly elected. It also has never disputed that those "directors" were purportedly elected by First Pennsylvania, which as purported "record holder of $1,500,000 shares of Eastern," voted such shares in favor of the subject "directors." Finally, the petitioner also has never disputed that First Pennsylvania did not have the right or authority to vote *as it did*[2] — it was never the owner or record holder of any Eastern stock.

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2. First Pennsylvania is not and has never been a shareholder of Eastern because it is undisputed that none of Eastern's stock has ever been registered in the name of First Pennsylvania. *See, e.g., Lee v. Riefler & Sons, Inc.*, 43 F.2d 364, 365 (M.D. Pa. 1930) ("The stockholder of a corporation means one

(Cont'd)

The petitioner argues merely that the Court should ignore what actually took place, and rule in favor of the petitioner based upon what could have taken place. Specifically, the petitioner argues that although First Pennsylvania called the October 31 special shareholders meeting as a supposed shareholder of Eastern and although it purportedly voted its own stock at that meeting, it *could* have accomplished the same end by, instead, voting SBI's stock in Eastern.[3] There are two problems with the petitioner's analysis; it is irrelevant, and it is erroneous.

A. The petitioner's contention that First Pennsylvania could have voted SBI's stock is irrelevant.

As discussed above, the petitioner's argument as to what First Pennsylvania supposedly could have done is irrelevant because, as recognized by the Supreme Court in *Price v. Gurney*, the only thing that matters is what First Pennsylvania did, not what the petitioner says First Pennsylvania could have done.

(Cont'd)

whose status as such appears on the books of the corporation. . . . A person who holds shares of stock in pledge, although the shares are assigned in blank by the registered owner, does not become a stockholder until the shares are transferred to him on the books of the corporation"). The Bankruptcy Court so acknowledged on page 4 of its opinion (App. 3:603).

3. The difference insofar as First Pennsylvania is concerned has enormous ramifications. As discussed on pages 3-4 of Eastern's December 3, 1982, Reply Brief in Support of its Motion to Dismiss Chapter 11 Petition for Violation of the Federal Bank Holding Company Act (App. 3:719-720), First Pennsylvania would have been acting in contravention of the Federal Bank Holding Company Act if it had acted as the petitioner suggested it could have acted. As a result, First Pennsylvania (contrary to the position taken herein by the petitioner), has advised the Federal Reserve Board that it did not acquire control of Eastern until October 1980, when SBI's stock in Eastern was supposedly transferred into the bank's name. *Id.* First Pennsylvania has never taken the position (advocated by the petitioner) that it had "the automatic right" to vote the pledged (Eastern) stock in the event of a default. Appellant's Brief to the Third Circuit at 19.

B. The petitioner's contention that First Pennsylvania could have voted SBI's stock in Eastern is erroneous.

It was expressly acknowledged in Eastern's brief before the District Court and in Judge VanArtsdalen's opinion that the pledged agreement was enforceable "as between the parties thereto" (SBI and First Pennsylvania).[4] The only question vis-a-vis the agreement relates to the effect of the agreement on Eastern — which was not a party thereto. The issue was summarized by Judge VanArtsdalen as follows:

> The agreement between SBI and First Pennsylvania was a valid agreement, binding between the parties to the agreement, nobody disputes that fact. . . .
>
> The problem is that although it was a binding agreement between SBI and First Pennsylvania, Eastern Bancorporation was not a party to that agreement, was not bound by the terms of the agreement as such and therefore any suggestions in the agreement that upon default, First Pennsylvania automatically became, in effect, the shareholder in place of SBI, certainly could not be binding or obligatory upon Eastern Bancorporation.[5]

The governing Pennsylvania statute, 15 P.S. §1506, provides as follows:

> . . . A shareholder whose shares are pledged shall be entitled to vote thereon, in person or by

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4. App. 1:014, 3:754.

5. App. 1:014-015.

> proxy, until the shares have been transferred on the books of the corporation to the pledgee or nominee, and thereafter the pledgee or nominee shall be entitled to vote the shares in person or by proxy.

The statute is clear and straightforward; the petitioner has never even contended that it is somehow ambiguous. Necessarily, therefore, the analysis of the effect of the pledge agreement on Eastern must not only begin with the statute, but must end with the statute. It expressly provides that a corporation (Eastern) whose shares are the subject of the pledge shall allow the pledgee (SBI) to vote such shares "until the shares have been transferred on the books of the corporation."[6] There is, as the District Court recognized,[7] simply nothing more that can or need be said.

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6. *See* 8A Pennsylvania Law Encyclopedia, *Corporations* §135 at 240. ("In the case of pledged shares of stock, the pledgor is entitled to vote the shares, in person or by proxy, until the shares have been transferred to the pledgee or nominee on the books of the corporation, and thereafter the pledgee or nominee is entitled to vote the shares in person or by proxy"). This is, in fact, hornbook law. *See, e.g.*, 1 *Collier on Bankruptcy* §4.05 at 594 n.27 ("One who asserts equitable ownership to all stock in a corporation is not entitled to exercise the rights and privileges of a stockholder and thus has no authority to institute voluntary proceedings").

7. App. 1:020 ("[I]t is clear that First Pennsylvania was simply holding as a pledgee until at least the time that it demanded that there be a transfer of the stock on October 24, 1980. 15 P.S. §1506, specifically provides that a shareholder whose shares are pledged, shall be entitled to vote thereon in person or by proxy until the shares have been transferred on the books of the corporation to the pledgee, and thereafter the pledgee shall be entitled to vote the shares in person or by proxy. The shares had not been transferred on the books of the Corporation to First Pennsylvania. . .").

II.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE FIRST PENNSYLVANIA HAD NO RIGHT TO SET THE DATE OF THE SPECIAL SHAREHOLDERS MEETING.

15 P.S. §1501(c) details certain requirements that must be met before a shareholder can call a special shareholders meeting. First Pennsylvania did not comply with that statute. Necessarily, therefore, in addition to the fact that this action was properly dismissed because the bank was never a shareholder in Eastern (*see* Point I, *supra*), this action was properly dismissed because the subject "directors" were not elected at a lawfully held shareholders meeting.

First Pennsylvania's failure to comply with Section 1501(c) is manifest and undisputed. The statute provides that a shareholder desiring a special shareholders meeting must make a "written request" to the company that such a meeting be scheduled. The secretary of the corporation then has "60 days after receipt of the request" in which to schedule the meeting. The shareholder is vested with the authority to schedule the meeting on its own only "[i]f the secretary shall neglect or refuse to fix the date of the meeting and give notice thereof."

There are, therefore, two prerequisites to a shareholder scheduling its own meeting: (i) a "written request" by it to the company requesting that the company schedule the meeting, and (ii) a failure by the company to schedule the meeting. Neither prerequisite was satisfied with regard to the October 31, 1980, shareholders meeting scheduled by First Pennsylvania. The bank did not, prior to scheduling the meeting, make any request whatsoever to Eastern that such a meeting be held, let alone allow Eastern the opportunity to consider and act on the request. It

is undisputed that the first Eastern learned of the October 31 meeting was on October 24, when First Pennsylvania had already scheduled a special shareholders meeting:

> First Pennsylvania Bank, N.A. the record holder of 1,500,000 shares of Eastern Bancorporation common stock has called a special meeting of shareholders for 10:00 a.m., October 29, 1980 [sic] at 1900 Land Title Building, Broad and Chestnut Streets, Philadelphia, Pennsylvania. . . .[8]

Summarizing, the subject special shareholders meeting was manifestly called in violation of 15 P.S. §1501(c).

III.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE FIRST PENNSYLVANIA HAD NO RIGHT TO VOTE AT THE SPECIAL SHAREHOLDERS MEETING.

15 P.S. §1509 provides that new shareholders are not entitled to vote at shareholders meetings until 10 days after the date on which they become shareholders. Even if one were to accept First Pennsylvania's position, therefore, that it became a shareholder of Eastern on October 24, it necessarily would not have been entitled to vote, as it did, at the October 31 special shareholders meeting.[9]

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8. App. 1:215.

9. Judge VanArtsdalen so held on pages 11-12 of his opinion (App. 1:021-022).

IV.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE EASTERN'S MINORITY SHAREHOLDERS WERE NOT GIVEN THE REQUISITE NOTICE OF THE SPECIAL SHAREHOLDERS MEETING.

The petitioner has never disputed that 15 P.S. §1502 requires that "written notice" of any meeting of shareholders "must" be given to "each shareholder" at least "five days prior to the day named for the meeting." The petitioner also has never disputed that there is no evidence that such written notice of the October 31 meeting was provided to all of Eastern's minority shareholders. The subject bankruptcy petition, therefore, having been authorized by "directors" elected at an unlawful shareholders meeting, was dismissed by Judge VanArtsdalen on that additional ground (App. 1:022-023).

Moreover, even the petitioner has not had the audacity to suggest that the rights of Eastern's minority shareholders can be disregarded simply because they own only a small percentage of Eastern.[10] There can be no question, therefore, not only that this case was properly dismissed both because First Pennsylvania was not a shareholder of Eastern and because it improperly set the date of the special shareholders meeting, but also that this case was properly dismissed because of the absence of timely written notice of the special shareholders meeting to Eastern's minority shareholders.

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10. *See, e.g., Steinberg v. American Bantam Car Co.*, 76 F. Supp. 426, 437 (W.D. Pa. 1948) ("The election of the directors should be orderly and with a full and complete opportunity for a participation of *all* the stockholders") (emphasis added); *Commonwealth ex rel. Claghorn v. Cullen*, 13 Pa. 133, 144 (1850) (minority cannot be deprived of the "opportunity to deliberate, and if possible, to convince their fellows" to vote differently).

V.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE THE PURPOSE OF THE SPECIAL SHAREHOLDERS MEETING WAS NOT DISCLOSED.[11]

Neither the petitioner nor the District Court disputed that in order for the October 31 special shareholders meeting to have been valid, First Pennsylvania must have notified the shareholders of Eastern of the "purpose" of the meeting.[12] First Pennsylvania failed to do so. As disclosed in an October 9, 1980, memorandum produced by First Pennsylvania, the bank called the special shareholders meeting in order to enable it to (i) *put Eastern into bankruptcy* and (ii) *use the bankruptcy proceeding in order to obtain control of State National Bank.*[13] It did not apprise any of Eastern's shareholders of those facts. Necessarily, therefore, First Pennsylvania's actions were invalid on that additional ground.

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11. Of the five independent grounds advanced by Eastern as to why its motion to dismiss should have been granted, this is the sole ground that was not expressly adopted by the District Court.

12. *See, e.g., Bagley v. Reno Oil Co.*, 201 Pa. 78, 83, 50 A. 769 (1902).

13. As detailed in the subject memorandum, which Eastern obtained pursuant to court order, the bank formulated a plan as early as October 9, 1980, to obtain control of Eastern's board, to have the board "approve and authorize a filing by E.B.C. of a petition under Chapter 11," and then to use the bankruptcy proceeding to "[s]eek a reversal of the dilution of E.B.C.'s ownership in S.N.B. to the 64% original level." The shareholders, who would obviously have been interested in First Pennsylvania's plan to take control of State National Bank (Eastern's only remaining asset was its SNB stock, and First Pennsylvania had already established its inability properly to manage even itself), were informed of nothing.

VI.

THE PETITIONER'S ASSERTION THAT BANKRUPTCY COURTS ARE COURTS OF EQUITY IS TOTALLY BESIDE THE POINT.

In its brief, the petitioner points out that bankruptcy courts are courts of equity. That assertion is totally beside the point. The subject Chapter 11 petition was dismissed for jurisdictional reasons — the persons who filed it on behalf of Eastern had no authority to do so under Pennsylvania corporate law.

CONCLUSION

In conclusion, Eastern was never properly put into bankruptcy because the persons who authorized the filing of the bankruptcy petition were not authorized to do so. Moreover, the absence of such authorization was no mere "technicality". If it were, the petitioner, rather that litigating this case all the way to the Supreme Court, would have merely remedied the lack of authorization by holding new elections.

For the reasons stated above, the District Court's decision granting Eastern's motion to dismiss the bankruptcy petition, and the Third Circuit's summary affirmance thereof, were manifestly proper and necessitated nothing more than a straightforward application of Pennsylvania corporate law. There are, therefore, no special or important reasons warranting the granting of a writ of certiorari.

Respectfully submitted,

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